The Future of Lomé: Europe's Role in African Growth

Paul Collier, Patrick Guillaumont, Sylviane Guillaumont and Jan Willem Gunning

I. INTRODUCTION

TRADE and aid relations between the European Union and the ACP developing countries are governed by the Lomé Treaty. This treaty entitles the ACP countries (former European colonies, mostly in Africa) both to EU aid and to trade preferences. ACP exports enjoy preferential access to the European market, mostly in the form of lower tariffs (subject to very restrictive rules of origin). These preferences apply in particular to traditional African exports such as tropical agricultural products. Since 1975 when the first Lomé treaty was signed the ACP countries have, in spite of this preferential treatment, lost market shares for their traditional exports while there has been little growth in non-traditional exports. A notable feature of the trade preferences is that they are (since 1975) not reciprocal: ACP countries are under no obligation to open their markets to European exports. The value of tariff preferences has been eroded as tariffs have been lowered for non-ACP countries. European aid programmes for ACP countries have moved beyond project aid to support for structural adjustment programmes (SAPs); as a result the conditionality of EU aid has become more prominent.[1]

The current phase of the treaty expires in the year 2000 and a discussion has started on its successor. This takes place against the background of considerable disillusion with the efficacy of aid transfers and unreciprocated 'special and differential' trade preferences (Grilli, 1993). So far it has tended to be polarised between those, notably African governments, who wish to preserve the status quo, and critics questioning whether Lomé should have a future at all. In this

PAUL COLLIER is from CSAE, Oxford University. PATRICK GUILLAUMONT and SYLVIANE GUILLAUMONT are from CERDI, University of Auvergne. JAN WILLEM GUNNING is from the Free University, Amsterdam. The authors are grateful for the comments of two anonymous referees on an earlier draft of the paper.

[1] An excellent account of the EU's trade and aid relations with ACP countries is given by Grilli (1993).

paper we argue that Europe can offer three things to Africa: aid, market access and institutions. To date, it has offered only the first two. We present proposals on how the present aid and trade relationships offered under the Lomé treaty can be transformed. In addition we will suggest that Europe can help African countries by institutional innovations which reverse the marginalisation which Africa has been experiencing.

The structure of the paper is as follows. In Section 2 we present a typology in terms of prerequisites for growth. We classify countries according to whether they currently satisfy these prerequisites and show that those which do, a minority, are in fact currently growing satisfactorily. In Section 3 we draw the implications of Section 2 for the future of Lomé. We discuss conditionality as presently practised and propose how this can be replaced by the three-pronged approach of performance-based aid, reciprocal market access, and participation in European institutions. Finally, we argue that these and other proposals should be options on a 'menu' from which African countries can choose. That is, we are proposing Lomé 'à la carte'. Differentiation among countries will be the outcome from self-selection among this menu.

2. PROSPECTS FOR GROWTH: A TYPOLOGY OF COUNTRIES

The vast majority of ACP countries are African. Africa is, of course, not a very meaningful aggregate. We need some way of relating differences in African performance to differences in African circumstances. This is not an easy task because policies are intrinsically difficult to aggregate. A recent attempt (World Bank, 1994) built inevitably precarious composite scores on macroeconomic policy and related these scores to performance. Such an approach tends to be so fragile that it is not convincing. Confining ourselves to the low income countries (below $1,000 per capita), the approach taken here is to filter the set of African countries through a series of three conditions which might be widely accepted as necessary for growth: a minimal degree of social stability, a minimal degree of macroeconomic stability and a minimal degree of allocative efficiency. We then look at the performance of those countries which survive these three filters. The idea is that these three filters form a policy hierarchy: without a minimum of social stability there is little point worrying about macroeconomic stability. Similarly, even with adequate social order, if there is macroeconomic chaos there is little point in worrying about allocative efficiency. This divides the African population into four categories. At the bottom is the population in countries involved in civil war, an extreme form of social instability. At the next stage is the population living in countries where the government has supplied peace but has not achieved minimal macroeconomic stability. At the third stage is the population living under governments which are supplying peace and macroeconomic stability but in which resource allocation policies are liable to be highly inefficient. Finally, there is the population in countries in which the government is supplying peace, macroeconomic stability and minimally adequate resource allocation policies.

While the definition of 'ideal' policies is, of course, controversial, this section is based on the premise that it is possible to get a broad consensus on what constitutes unambiguously dysfunctional economic environments. The most basic feature of the 'minimum adequate environment', without which economic policy change is likely to be futile, is peace, and this is the first of our filters.

a. *Economies without Peace*

The extent of violence in a society is a continuum, as is its scale of organisation. However, as demonstrated by cities such as New York, it is possible for a high level of unorganised violence to co-exist with a high level of prosperity: such violence is evidently not a severe impediment. By contrast, the prolonged civil wars which have occurred in Africa have caused an enormous loss in output. Collier (1996) estimates that civil war reduces growth by 2.2 per cent per annum, so that the prolonged civil wars in Mozambique, Ethiopia and Uganda have reduced incomes by around 30 per cent. Further, civil wars tend to leave a legacy of a weakened state in contrast to international wars. Herbst (1990) argues persuasively that a reason why African states tend to be weak is that they have not faced external threats.

Because civil wars are informal they are usually not discrete episodes such as international wars and so their definition is to an extent arbitrary. Singer and Small (1994) provide precise, quantitative criteria, on which they identify all civil wars from 1816. However, their listing does not extend beyond 1992. In the absence of a current objective classification, in the spirit of this paper we only classify countries as being engaged in civil war where the evidence is such that there would be widespread consensus and where the effects can reasonably be expected to include severe impediments to economic growth. Currently six African countries fall into this category: Angola, Burundi, Liberia, Rwanda, Somalia and Sudan. It is not in fact possible to tell whether this group is in aggregate in economic decline because for half of them there are no National Accounts data. For the remaining countries per capita GDP fell by four per cent p.a. in 1990–94. The population of these six countries is 61 million, so that around 12 per cent of the population of Africa is living in countries in which the government has failed to supply a minimal adequate level of social order.

b. *Economies without a Minimum Adequate Macroeconomic Environment*

The next filter concerns the macroeconomic environment. Again this is a continuum and so it is intrinsically arbitrary where a line is drawn. Here we use a classification based partly on inflation in the three year period 1992–4. We use a boundary at which inflation policy is not deemed to be even minimally adequate at an inflation rate above 25 per cent. This is supplemented by a scoring system developed by World Bank country economists (Bhattasali and Ray, 1995). For the criteria to be genuinely minimal, most low income developing countries should satisfy it. Among non-African IDA-receiving countries 85 per cent meet the criterion.

The following African countries which satisfy the condition of peace currently fail to meet the requirement of macroeconomic stability: Comoros, Equatorial Guinea, Ghana, Madagascar, Malawi, Mozambique, Niger, Nigeria, Sao Tome and Principe, Tanzania, Togo, Zaire and Zambia. This group covers 240 million people, which is 46 per cent of the population of Sub-Saharan Africa. Excluding Zaire for which no National Accounts data are available after 1992 (in which year income fell by 10 per cent), per capita income fell by 1.2 per cent p.a. for this group in recent years.

Hence, just over half of the population of Africa lives either in a country which is simply unsafe or is subject to severe macroeconomic instability (or both). In this half of Africa we do not need deep explanations in terms of economic policy as to why growth is low, we need analysis of the causes of civil war and the reasons why governments are not supplying a minimum adequate macroeconomic environment.

c. Economies without a Minimum Adequate Resource Allocation Environment

For the countries with minimum adequate environments in terms of social order and macroeconomic policy we now consider the policy environment with respect to resource allocation. It is immensely difficult to get good quantitative measures of the efficacy of resource allocation policies. The only resource allocation indicator which is as readily measurable as the major macroeconomic indicators such as inflation is the premium on the parallel market for foreign exchange, which can be interpreted as a proxy for trade and exchange rate restrictions. Easterly and Levine (1995) show that the parallel market premium is significant and important in explaining slow growth overall in Africa and variations between countries. However, this is only one of many areas in which policy can affect the allocation of resources and hence growth. We take five policy areas which concern resource allocation: trade and exchange rate systems; the financial sector; factor and product markets; parastatals; and the composition of public expenditure. Again we utilise a scoring system used by World Bank country economists in which each policy area is evaluated according to reasonably precise criteria (Bhattasali and Ray, 1995). Each policy is classified according to whether it meets a minimum threshold. We classify countries as having minimum adequate resource allocation policies if each of the five policies is above this threshold.

The countries which fail to survive this filter, and so are categorised as having achieved minimum adequate social and macroeconomic order but inadequate resource allocation policies are the following: Cameroon, Chad, Congo, Eritrea, Guinea, Kenya, Lesotho and Zimbabwe. These countries have a combined population of 69 million, or 12 per cent of the population of Africa. Treating this group as a single aggregate economy, and summing its GDP (at constant 1987 dollars: from *African Economic Indicators*, Table 2.1) the growth rate for per capita GDP in 1992–94 was −2.8 per cent. Hence, this population was experiencing rapidly declining incomes.

d. Countries with a Minimum Adequate Environment

The above filters leave a group of low-income countries whose governments are currently supplying at least modest levels of social order, macroeconomic order and resource allocation. In combination these yield what we will term a *minimum adequate environment.* The countries which currently have such an environment are Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Ethiopia, Gambia, Guinea Bissau, Mali, Mauritania, Senegal and Uganda. Between them these countries account for 23 per cent of the population of Sub-Saharan Africa. For these countries it is highly pertinent to determine whether the provision of a minimum adequate economic environment achieves what might be thought of as minimum adequate growth. Since our classification of the economic environment is based on data as of 1996, as we take longer periods over which to assess growth performance more and more countries drop out because they have only adopted a minimum adequate economic environment recently. The most recent members of the group are the five countries which are members of the Franc Zone. Until the devaluation of the CFA franc in early 1994 these countries had inadequate resource allocation environments because of the over-valuation of the currency. Output changes during 1994 might reflect only transient responses. During 1995 the average GDP growth of this group was 6.2 per cent (Table 1) or 3.2 per cent on a per capita basis (Table 2).

While this is not a particularly high growth rate by the current standards of some other developing countries, it should be recalled that this group is defined not by particularly growth-friendly policies but only by the avoidance of manifestly growth-hostile policies. It suggests that the criteria which have been used to define this group indeed justify the term 'adequate' in that the growth which the environment appears to be generating does appear to enable growth rates which permit per capita incomes to rise reasonably rapidly. This should, to an extent be qualified, since during 1995 the term of trade for most of these countries were improving and this would have temporarily raised their growth rates.

TABLE 1
1995 Growth Rates for African Countries with a Minimum Adequate Economic Environment

Country	*Weight*	*Growth Rate*
Benin	0.0548	4.5
Burkina Faso	0.0668	4.2
Cape Verde	0.0120	4.8
Cote d'Ivoire	0.2414	4.8
Ethiopia	0.1686	8.0
Gambia	0.0131	−4.1
Guinea-Bissau	0.0087	4.2
Mali	0.0673	6.0
Mauritania	0.0368	4.6
Senegal	0.1395	4.8
Uganda	0.1439	9.5
All	1.000	6.2

Sources: Growth rates: World Economic Outlook data base, IMF. GDP weights derived from *African Development Indicators*, 1996, World Bank.

TABLE 2
The Population of Sub-Saharan Africa in Five Environments

Environment	*Population Share*	*Performance: Per Capita GDP Growth*
Inadequate social order	12%	−4.0% 1990–4
Inadequate macro policies	46%	−1.3% 1992–4
Inadequate resource allocation	12%	−2.8% 1992–4
Minimal adequate environment	23%	+3.2% in 1995
Already middle income	8%	n/a

Source: Growth rates from African Development Indicators 1994–95, and country National Accounts.

e. Summarising the Minimum Adequate Environment Filters

To summarise, the African population can be grouped into the five environments set out in Table 2. This table has implications for the focus of concern about current African economic performance. First, it suggests that the major problem in Africa is not that performance has been poor even when economic policies have been reformed. Recall that our criteria for the policy environment have deliberately been minimalist. Many of the countries which are in this final category have policies which by no stretch of the imagination could be described as growth-friendly. For example, Ethiopia has yet to get in place even elementary property rights: it is not yet possible to purchase land on which to build a factory, and the financial system is rudimentary, since until 1995 there was a monopoly state commercial bank. Indeed, none of the countries actually rate high across the board on macroeconomic and resource allocation policies.

Despite this, the economies in which a minimum adequate economic environment has been created are performing rather well. A growth rate of 6.2 per cent is not remarkable, and it is worth efforts to raise it, but were it replicated across the continent there would be a mood of confidence rather than crisis. The table identifies as the problems the three groups which lack different features of the minimum adequate economic environment. Each of these groups faces declining incomes.

The most severe problem in terms of human suffering is probably the war-torn societies, characterising 12 per cent of the African population. Recent work (Collier and Hoeffler, 1996) shows that unlike international wars, the danger of civil wars is strongly persistent: countries which have had a recent civil war are much more prone to further conflict. However, they also find that the most common explanation for African civil wars, ethnic divisions, is not correct. Using an index of ethno-linguistic fractionalisation first used by Mauro (1995), they find that highly fractionalised societies are no more prone to civil war than homogeneous ones. It is countries with middle levels of fractionalisation, such as occurs if a population is divided into two similarly sized ethnic groups, which most endangers peace. Hence, the high degree of fractionalisation which characterises many African countries need not be war-inducing.

There are two groups, totalling just over half the population of Africa, which are currently experiencing decline and where that decline can reasonably be attributed directly to economic policies: those without a minimum adequate macroeconomic environment and those without a minimum adequate resource allocation environment. Within this half of the population the major problem is evidently chronic macroeconomic instability rather than poor resource allocation. An amazing 46 per cent of the population is subject to governments which are failing to provide a basic macroeconomic environment suitable for growth. Indeed, once we remove the war societies and the middle-income countries, the population is fairly equally divided between those inhabiting areas of minimal macroeconomic stability and those in unstable environments. Since half the population has minimally adequate macroeconomic policies this is a hopeful sign for the other half: adequate macroeconomic policies are not rare, they are common, but not nearly universal as they are now in other low income countries. Turning from macroeconomic instability to the lesser problem of resource misallocation, the message is even more hopeful. In that part of low income Africa in which there is an adequate macroeconomic environment, two thirds of the population now has minimally adequate resource allocation policies. The 12 per cent of the population which lives under governments which fail to provide this are in exceptional conditions.

Hence, a favourable interpretation of Table 2 is that the two policy transitions which between them would transform the environment for half the population from decline to growth are already normal in Africa. If half the secure low income population can have macroeconomic stability why cannot this be extended to the other half? If two thirds of the secure, low income, macroeconomically stable population can have adequate resource allocation policies, why not the other third? However, the central message of the table is that at present only a quarter of the low-income population has an even minimally adequate environment. Of course it is important to press ahead to raise growth rates in the minimally reformed economies to the double digit levels of which these economies should be capable. However, it is more important, and in a sense far easier, to deliver a minimalist environment to those who currently lack even that. Although we know that it is feasible for developing economies to grow much more rapidly than the rates currently being achieved by those African countries with a minimum adequate economic environment, controversy sets in precisely at the point of moving from this environment to a growth-enhancing environment. Specifically, disputes arise between 'developmental state' and 'level playing field' approaches. While this debate is important and interesting, it should not be allowed to obscure that there is consensus on the far more important task of providing a minimum adequate economic environment for the majority of the African population which currently lacks it.

3. IMPLICATIONS FOR THE FUTURE OF LOMÉ

In the previous section we have argued that less than a third of Africa lives in countries with even a minimum adequate economic environment and that risk is a major deterrent to growth. In effect we are suggesting necessary and sufficient conditions for rapid growth. The necessary conditions, which are not satisfied in most of the continent, are the provision of a minimum adequate environment. Where this is in place it seems currently to be capable of delivering respectable, though not spectacular growth rates. However, even the countries with this environment suffer from high risk. In order to raise investment to the levels consistent with rapid and sustained growth, it will be necessary to reduce these risks. We now consider how the European Union can induce rapid growth by assisting both in the transition to the minimum adequate environment and in the reduction of risk. As noted in Section 1, the European Union has three instruments for assisting: through aid, through market access, and through participation in institutions. In principle, each of these instruments might be effective in the three transitions necessary to attain a minimum adequate environment, and in the reduction of risk. We consider them in turn.

a. Aid

We now consider the contribution which aid can make to the first of the three transitions, namely that from civil war to peace. Unfortunately, the effect of aid on social cohesion is ambiguous. While it is possible that by increasing the resources available to the government it enables the government to satisfy opposition groups which would otherwise resort to violence, it is also possible that the extra resources enable the government to increase its military expenditure (Azam, 1995). Similarly, while aid may increase the incentive for a government to reach a settlement, it may also reduce the need for a government to democratise (Bates and Collier, 1995). Collier and Hoeffler (1996), quantify the effect of income from natural resources on the risk of civil war, an effect which might simulate that of aid. They find that the relationship is non-monotonic, only reducing the risk of war when the endowment is large. The implication is that while in any particular situation aid might have a clear effect, there is no general presumption that it can be used to induce a transition to peace.

Now consider the role of aid in promoting macroeconomic stability. Since commodity price instability is largely due to natural conditions and the functioning of the world economy it is an illusion to think that instability can be easily reduced. The failure of international commodity price stabilisation efforts is vivid testimony to this fact. The European Union already has a policy instrument by which aid can compensate for negative shocks, namely Stabex. In practice much of the instability generated by shocks arises from the mishandling of positive shocks (Collier and Gunning, forthcoming). However, even with respect to negative shocks Stabex currently fails to achieve its objective. The delays in disbursement are so long that Stabex flows are actually pro-cyclical (Hermann et al., 1990). This has arisen because Stabex has come to be used for multiple donor objectives. In order for Stabex to contribute to macroeconomic stability, disbursements evidently need to be prompt and this necessarily implies that they should not be subject to complex conditions. However, there is a deeper problem in using Stabex to reduce the impact of negative shocks for there is a trade-off between stabilising the income of the country and stabilising the income of exporters, both of which are ostensible objectives of Stabex. When world prices are low, exporters are partly compensated by a fall in the relative price of non-tradable goods, but this would be offset by Stabex inflows. Hence, the same instrument which compensates income at the national level accentuates the loss of income for exporters themselves. Thus, while Stabex as currently operated is seriously flawed, it is not easily remedied.

A further means by which aid is used to promote macroeconomic stability is through conditionality. However, as with the use of aid in the transition to peace, it is a two-edged sword. The provision of aid in return for sound macroeconomic policies clearly provides some incentive for governments to adopt them, though the fact that 46 per cent of the African population is currently living in an inadequate macroeconomic environment suggests that this incentive is not very powerful. However, offsetting this favourable (though possibly weak) effect, conditionality may actually contribute to instability. This is because if a condition is not met, in principle aid is cut off, creating macroeconomic crisis. There are several examples of crises being induced in this way, for example, Uganda in 1992.

Now consider the contribution which aid can make to the transition to minimum adequate resource allocation policies. This is the contribution envisaged for structural adjustment lending. Implicit in this use of aid is a difference between donor and recipient objectives: apparently the recipient government is not willing to adopt policies considered desirable by the donor without being induced to do so. The main objection to the use of aid as inducement for policy reform is that in this case the government receives aid *ex ante*, on the basis of the promise of a policy change. The government then has an incentive to minimise implementation of the agreed adjustment programme and to reverse the policy changes once the temporary aid runs out. This has contributed to the familiar phenomenon of policy reversal which has cumulatively reduced the credibility of all African reform programmes and so undermined investment.

Since the government is placed in the position of 'selling' reforms to donors, it has an interest in maximising the 'price' of reform. That is, for a given amount of aid it will attempt to do as little reform as possible, by exaggerating the difficulties of adopting the reforms and indeed by periodically reversing them or introducing new policy distortions which can subsequently be 'sold'.

In response to this, donors have increasingly adopted 'short-leash' policies. That is, they have specified the implementation of reforms in increasing detail both as to content and timetable, linking disbursement of funds to each step of implementation. Tranches are released on the basis of this highly detailed specification of performance, monitored over very short periods. At present this approach frequently encounters a credibility problem because the entire programme aid flow is conditioned on each step of reform. Hence, the donors periodically face the choice of interrupting the aid flow because of some minor infringement of the promised reform programme or of waiving the agreed conditions. The former option risks plunging the country into macroeconomic turmoil because of trivial slippages, while the latter undermines donor credibility.

One solution to this dilemma is for the 'pricing' of reforms to be taken to its logical conclusion so that each detail of the reform programme entitles the country to a specified amount of aid. The problem with such an approach is that donors become involved in the details of government to an inappropriate degree, thereby weakening 'ownership' of economic policy by the government. Indeed, if the government has 'sold' policies to donors, the ownership of policy quite clearly belongs to the donors. If the government's actions are specified in detail for short periods it cannot feel responsible for the decisions which it takes. Hence, the attempt by donors to 'purchase' reforms piecemeal has paradoxically been to place governments in the position of slowing the implementation of reform and of making the private sector suspicious of government intentions.

The perceived failure of short-leash lending, in particular its inconsistency with government ownership of policy change, has increased pressure for greater selectivity between countries in aid disbursements. There are two quite distinct rationales for selectivity. The rationale for confining aid (other than that for humanitarian purposes) to governments which are providing a Minimum Adequate Economic Environment can simply be that without an adequate policy environment aid is liable to be unproductive. Hence, simply to avoid waste there is a case for selectivity: aid would be restricted to those poor countries in which it could be useful. In its extreme form this rationale would take a far more modest view of what aid can achieve than implied by the conditionality approach. Instead of regarding government economic policy as highly malleable in response to donor wishes, in the limit policies might be seen as being invariant with respect to donor preferences. Donors would simply support those governments which happened to provide an adequate policy environment.

The second rationale for greater selectivity is that, redesigned, conditionality could provide a more effective incentive for policy change. The redesign would be that aid disbursements would be based upon performance rather than promises and that performance would be measured by periodic broad assessments rather than by continuous 'short-leash' monitoring. This is the 'inducement' use of aid, but now conducted ex post rather than ex ante. Since the payment would be conditional upon performance rather than promises, this form of inducement would not lead to time inconsistency. It may therefore prove more effective than ex ante conditionality.

Specifically, donors would announce at the beginning of a period outcome-contingent aid to be disbursed at the end of that period. The recipient government would therefore know how much aid it would receive if, during the period, it was successful in some pre-defined sense. One way of linking aid to performance might be to base criteria upon a continent-wide average. For example, the country would receive a 'normal' amount of aid if it achieved at least the Africa-wide average on each of a range of indicators. Below this, aid would gradually decline to zero as a function of the shortfall of performance compared to the average.

The 'normal' amount of aid would be determined with reference to the country's per capita income: a poorer country qualifying for more aid. Donors might use a variety of indicators of performance such as the rate of growth of GDP, the change in literacy, the change in child mortality and even the change in the protection of civil rights. In each of these cases the donor would at some stage need to determine how aid would be related to the indicators and so decide upon trade-offs between them.

Performance above the norm might be rewarded with additional aid, in which case the government would have an incentive to perform better than average.

Alternatively, donors can choose to be prescriptive only about poor performance, thereby attempting to reconcile the attainment of their own preferences with the ownership of policy by the government.[2]

An obvious objection to the use of quantitative performance measures for aid allocation is that performance is not fully under the control of the government. For example, a country may perform poorly in terms of GDP growth over the period under review simply as a result of a negative commodity price shock. To some extent this can be corrected for: elsewhere we have used cross-country regressions to correct growth performance for country characteristics such as land-lockedness and for terms of trade changes (Collier et al., 1997). However, the scope for such adjustments is limited, particularly for performance indicators which are not widely available, such as changes in poverty measures over time. Hence an element of judgement in the interpretation of performance indicators will be unavoidable.

b. Market Access

From the very beginning the relations between Europe and Africa have involved preferential access to the European market (Grilli, 1993). Initially this was reciprocal, free trade arrangements between colonial powers and their colonies being extended to trade between the ACP countries and Europe. The first Lomé treaty (in 1975) dropped the reciprocity. From thereon ACP countries continued to have preferential access to the European market but did not have to reciprocate by lifting trade restrictions on imports from Europe.

The preferential access to European markets was best for commodities which were the traditional exports of ACP countries such as bananas and sugar. For manufactures, subject to quota limits, ACP countries benefited from protection *vis-a-vis* East Asian competition. For temperate agricultural produce which competed directly with Europe, access was much more restricted.

This pattern of preferences would have tended to perpetuate a concentration of African exports on traditional products. Over the past twenty years African exports have remained very heavily concentrated upon a few primary commodities. Until very recently this bias in European trade policy could not, however, account for this persistence of concentration because the economic policies pursued by African governments were strongly anti-export oriented and so prevented diversification. Only in the last few years have some African countries sufficiently reduced this anti-export bias for a new range of exports to become feasible. Hence, it is only now that market access issues have become important in constituting a binding constraint.

We propose that market access be altered in Lomé V in two respects. First,

[2] We develop this argument further in (Collier et al., 1997).

market access should be improved for the non-traditional African exports. The strategies for improvement would differ as between agriculture and manufactures. For agriculture the recent tariffication of quotas often at very high levels of tariffs, affords plenty of scope for ACP preference. For manufactures tariffs are now so low as to be largely irrelevant, so that tariff preference is no longer of consequence. Indeed, the level of preference is now so low that in many instances importers find the administrative costs of benefiting from the preference to exceed its value. However, non-tariff barriers to manufactures remain important. This is despite the Uruguay Round having negotiated the gradual tariffication of non-tariff barriers. The most important remaining restriction is now not quotas themselves but the threat of anti-dumping actions. The legal framework for anti-dumping actions is sufficiently generously phrased that the potential scope of such actions is very wide. Indeed, this was the price exacted by developed countries for the concession of tariffication. The European Union already restricts the use that its members can make of anti-dumping suits. First, no member government can bring a suit against the firms of any other member government. Secondly, and more pertinently, this has now been extended beyond Union membership. Iceland has been granted the same privilege as Union members in that anti-dumping suits cannot be brought against Icelandic firms by EU members.

Anti-dumping suits are much more important than their current frequency would imply. Because they can be mounted relatively easily, they constitute a threat to firms in developing countries contemplating exporting and this threat is now recognised as 'contingent protection'. The existence of this threat is much more important as a disincentive to manufacturing in newly emerging manufacturing centres, such as it is hoped that Africa may become in the next decade, than in the established centres of East Asia. This is because established firms already have diversified markets often including a reasonably sized domestic market. For example, a Korean firm subject to an EU anti-dumping action could continue to sell in North America and expand its sales in Korea. By contrast, a new manufacturing operation in Ghana which was selling into Europe as its most important initial market might have many fewer options if this market access was suddenly interrupted. Thus, we propose that under Lomé V the parties (the EU and the ACP countries) would undertake to refrain from anti-dumping actions. Since Lomé V cannot bind the parties beyond the period of the treaty, this undertaking would automatically be time-limited and so the consequences for European firms would not be dramatic. The extent to which the concession conferred something of real value to Africa without exposing European firms to unrestricted competition would depend upon how rules of origin were specified. Very generous rules of origin would induce a relocation of assembly activity from East Asia to ACP countries, benefiting East Asia rather than Africa and exposing European firms to East Asian competition. Highly restrictive rules of origin would prevent manufacturing taking place in Africa at all since many parts of products would have to be imported due to the small scale and range of African manufacturing. Hence, the concession on refraining from anti-dumping need be far less dramatic than it might at first appear: it would be limited both by time and by rules of origin. It would, however, substantially improve the incentives for manufacturing in Africa rather than East Asia in one important respect, namely risk.

Survey evidence of actual and potential investors into Africa shows that at present the main perceived constraint is the high level of risk of African investment. This is consistent with cross-section analyses which find that investment is correlated with country risk-ratings (IFC, 1995). Further, recent work suggests that the risk ratings themselves are unduly harsh for Africa relative to the underlying objective characteristics (Haque et al., 1997). Thus, Africa is currently suffering from a poor reputation which discourages foreign direct investment (and possibly also domestic investment). Because contingent protection is now an important risk factor for exporters of manufactures in developing countries, the granting of an anti-dumping restraint to Africa would give it a risk advantage over East Asia which would at least qualitatively offset this differentially high risk. This advantage might well induce firms to incur the costs of gathering information on the prospects for investment in Africa. Survey evidence shows that at present the vast majority of firms looking for a developing country location do not even include Africa on their short list and hence never incur these costs. Until firms gather such information their decisions are inevitably going to be unresponsive to changes in African domestic policies.

We propose that trade relations be returned to their original reciprocal basis. This could take the form of a North-South free trade area, as in the case of NAFTA (Collier and Gunning, 1995). The preferential access to the European market (including the protection against anti-dumping suits) would then be contingent upon African trade liberalisation. The reason for this proposal is not that it would benefit Europe, although there would be some modest benefits, but that it would benefit Africa. During the past decade most African countries have substantially liberalised their trade policy usually in the context of structural adjustment programmes. These trade liberalisations have suffered from policy reversal. Oyejide et al. (1997) show that of ten African countries which undertook trade liberalisations there were reversals in seven of them. In some of these countries there was indeed a series of reversals, liberalisation episodes being separated by periods in which trade controls were reintroduced or tightened. Since import controls are equivalent to a tax on exports, this pattern of behaviour constituted an unpredictable set of incentives for the export sector. Because of this high incidence of reversal, firms were probably reluctant to invest in new exporting ventures and this may account for the low export supply response in Africa during the structural adjustment period.

African governments have thus liberalised with only limited credibility. This low level of credibility has been exacerbated by the tendency of donors to 'buy' trade liberalisation, so that it is not 'owned' by the government, as discussed earlier. Under the proposed arrangement trade liberalisation would be credible because the proposal offers a 'lock-in mechanism'. If a government were to restore trade restrictions it would thereby lose the valuable access to the European market. This use of reciprocity as a restraint mechanism on policy reversal is after all how European countries themselves achieved intra-European trade liberalisation. The massive change in the political balance of power in favour of liberal trade which would be achieved by reciprocity can be seen by considering the ability of a Minister of Trade to resist pressure from a domestic lobby seeking a return to protection. Reciprocity would give the minister the strong argument that such a return would incur a penalty of loss of market access so that other firms would suffer. Indeed, this was a major reason for the Mexican government wishing to join NAFTA. The government thereby hoped to lock in its economic reforms and the efficacy of this strategy has been demonstrated by the fact that despite the financial crisis a subsequent Mexican government has maintained liberal trade.

While in principle such an arrangement could apply to an individual ACP country, in practice there are too many countries for individual negotiations to be realistic. We therefore propose that the North-South free trade area involves regional groupings of ACP countries. In this case, membership of such a group would involve both free access to the markets of other member countries and privileged access to the European market. For such a regional group to function effectively its membership should be small. There are, however, already many such regional groupings in Africa. The challenge has been to make any of these regional cooperation institutions effective. This challenge has already been taken up by the European Union through the Cross-Border Initiative (CBI). By linking the CBI to reciprocity with Europe, intra-Africa regional cooperation would be made much more effective. The same incentive which would police African free trade with Europe would police intra-African free trade. For example, in 1994 despite membership of the PTA and donor conditionality on trade policy, the government of Kenya banned maize imports from Uganda. However, had Kenyan manufacturers been at risk of forfeiting access to European markets, there would have been a sufficiently powerful domestic lobby within Kenya to have prevented the imposition of this trade restriction, or to have got it rapidly reversed.

The limited credibility of unilateral trade liberalisation produces expectations which are self-fulfilling, notably a collapse in private investment, which is a severe problem in the reforming African economies. Governments therefore need all the lock-in devices which they can get: conditionality, WTO, MIGA, reciprocal agreements with the North along the lines of NAFTA (Collier, 1995). At present these lock-in devices are failing. Conditionality is largely ineffective because in practice aid flows have not been related to performance (Burnside and Dollar, 1996; and Boone, 1996). The GATT/WTO has not been used to bind tariffs by African governments other than South Africa and Zimbabwe. Further, the major mechanism by which African governments would re-impose trade barriers, foreign exchange rationing, is actually permitted under current WTO rules. Reforming African governments need a rule change which would impose the same penalties for this means of reversing liberalisation as for others. Although African governments have been interested by the NAFTA model they have misinterpreted its significance, seeing it as a *continental* agreement rather than as a North-South agreement. Hence, they have focused on the chimera of a Pan-African Common Market rather than on forging links with the EU.

c. *Institutional Innovation*

One of the important respects in which the European Union has a comparative advantage over both national donors and the IFIs is its capacity to generate supra-national institutions. Above we have already proposed one such innovation, namely, the creation of reciprocal free trade areas between Europe and ACP regional groupings. However, the principle of creating institutions with which African governments can choose to become associated is much more general than this.

For countries which have peace but an inadequate macroeconomic environment Europe has an important potential role in facilitating the transition. For example, in the area of monetary policy ACP countries could be offered associate membership of the emerging European monetary institutional arrangements. The Franc Zone for many years provided a mechanism through which some African governments could achieve a degree of macroeconomic stability through cooperation with France. The prospects for EMU provide an opportunity for a similar arrangement for all ACP countries with Europe replacing France. The rules of such a currency zone need not be identical to those of the Franc Zone. Since the EU member countries have already established 'convergence criteria' for membership of a currency area, at one end of a range of options, the same criteria could be applied to ACP countries seeking associate status. However, weaker forms of monetary association might also be negotiated. An ACP country might, for example, retain its own currency but adopt a fixed, adjustable parity, guaranteed by the European Monetary Institution subject to the government meeting budgetary criteria. The convertibility guarantee itself might cover either all transactions or exclude capital transactions. Hence, there would be a spectrum of monetary integration with Europe along which ACP governments might choose to position themselves. Evidently, full association into the Euro-zone would carry the strictest rules of fiscal behaviour, while more limited forms of association would have correspondingly weaker fiscal requirements.

Some countries would find one of these options attractive, others would not. The approach would be that ACP governments would have the right to apply for Euro-Zone association. An analogy would be the right of European Economic Area countries to sign up for EU economic policies even though they do not have rights to participate in the design of those policies. An example of an ACP government which indeed chose to relinquish its national currency after a disastrous record of macroeconomic instability is Equatorial Guinea, which chose to join the Franc Zone. The move to a Euro-Zone would permit much larger ACP economies to join.

The loss of the exchange rate as a policy instrument which full association would imply would impose some costs which would vary country by country. Those countries highly exposed to external shocks and with limited degrees of internal price flexibility might find it more advantageous to maintain adjustable national currencies, possibly combined with weaker fiscal criteria. However, especially in those ACP countries with severe macroeconomic instability, there are very few institutional price rigidities, partly because the formal economy is so small. In Zaire and Nigeria, which are the important instances of a failure to provide a minimum adequate level of macroeconomic stability, the pay-off from re-establishing monetary stability might well outweigh the costs of reduced relative price flexibility.

For countries which have peace and an adequate macroeconomic environment but which have very poor resource allocation policies, the scope for European Union intervention through institution-building is more limited. At present, the main reason why countries fail to provide an adequate resource allocation environment is because of poor parastatal performance or poor composition of public expenditure. To the extent that poor resource allocation is due to trade restrictions the institutional innovation of reciprocal free trade discussed above would, however, contribute to a better policy environment.

We now turn to those countries which have already achieved an adequate policy environment. For this group the EU has much potential to improve performance through institutional innovations by reducing the level of risk facing investors. The European Union is in the process of harmonising aspects of European commercial law and of harmonising standards for many professions including procedures for professional accreditation.

The environment faced by economic agents is unstable not only because of changes in macroeconomic policies but also because the judicial system and the way in which it is applied often changes. New economic policies, or even the adoption of new judicial systems, can only have a very limited effect on investment unless they are perceived as stable. This makes it important for the international community to search for mechanisms which reinforce the stability of policies and rules. One mechanism is the provision by the European Union of arbitrators. A second is that the simultaneous adoption of procedures by several states supported by external aid and technical assistance is more likely to be stable than unilateral adoption. Individual states face pressure from various socio-economic groups and lobbies, which is reduced if the rules are supra-national.

In much of Africa commercial law has atrophied so that many modern developments are simply not covered. The task of piecemeal updating of the legal framework is sometimes a very considerable one, often precisely in those countries in which the legislative process is least able to undertake it. The European Union could assist in the process of bringing African legal systems into line with modern practices. There is indeed a very long tradition of attaining a satisfactory legal code by means of importing and incorporating parts of other codes. For example, in the middle ages when Europe expanded into Slavic and Islamic areas, new settlements frequently adopted the legal charters of existing towns. The new towns thereby drastically reduced the costs of establishing a set of commercial law without in any way infringing their own independence of action (Bartlett, 1994). Bringing African and European commercial laws more closely into line might reduce the costs of entry for new investors. At the same time it would reduce the cost to African governments of updating commercial law to modern conditions. Currently France is supporting attempts of Franc Zone member countries to harmonise commercial law and insurance regulations, partly by setting up regional courts of appeal under the OHADA Treaty. The specific European Union role would be partly the funding of training and technical assistance, and partly the coordination of reforms of legal systems. Regional integration within Africa would be facilitated by some convergence of commercial laws and the European Union already has experience in the process of the harmonisation and reconciliation of legal systems with very different roots.

In several critical professions such as accounting, African countries have been unable to reproduce the self-regulation which has characterised enforcement procedures in the European Union. Because of this gradual weakening of self-regulation, standards of conduct have been eroded. Tirole (1992) shows how the incentive to avoid opportunistic behaviour is dependent upon the possession of a 'good' reputation which it then pays to maintain. Where a profession on average has good conduct, new entrants to the profession inherit the reputation of the group and therefore have an incentive to behave well. However, once the profession has lost this reputation for honest conduct, new entrants become tarnished by group behaviour: the expectation is that they may behave opportunistically, and so if indeed they do so, they are not destroying the asset of a good reputation. Bad behaviour is thus persistent because it is not in anyone's individual interest to recreate the public good of a good reputation for the professional group. African countries will find it difficult to break out of this problem, but the establishment of the accreditation procedures of European professional groups may offer a way out of this trap. In effect, sub-groups of African professionals would be able to signal that they were different and so cease to be tarnished by the conduct of other members of the profession. Once a sub-group was clearly identifiable as less opportunistic, users of the profession would shift demand to that group thereby providing an incentive for its expansion. The role of the European Union in facilitating such a development would be partly financial and partly coordination. Finance would be required both for the training of African professionals to the standards adopted by European professional associations, and for the subsequent supervisions conducted by the associations to ensure that their members are maintaining these standards. Coordination would involve the European Union offering the possibility of accreditation of African professionals to an African government, and the EU and the African government then jointly encouraging their professional associations to link up to undertake the necessary training and supervision. As part of this the African government, as a major user of professional services, would set a timetable for its own conversion to using accredited professionals. For example, at the end of this period the government would for its own auditing use only accredited auditors.

Taking into account the monetary fragmentation of Africa, the exchange rate instability of many African countries, and the fact that investors associate instability perceived in any one country with the continent as a whole, there probably is considerable scope for Europe-Africa cooperation in this area. This could involve the monetary arrangements discussed previously, but also regional judicial institutions such as arbitration commissions and regional guarantee agencies for international investments.

4. CONCLUSION

Because African performance is widely recognised as having been unsatisfactory, there is a strong case for designing Lomé V to be substantially different from Lomé IV. In practice, Lomé IV was characterised by non-reciprocated trade concessions and programme aid disbursed on the criteria of detailed *ex ante* conditionality. We have proposed five innovations. The first was to make aid performance-based with performance assessed in broad rather than detailed terms. Secondly, we have suggested that the actual operation of Stabex is in need of modification to make it more consistent with its objectives (the specific proposals for which are the subject of a separate study). Thirdly, we have proposed that the European Union should offer reciprocal regional free trade agreements to ACP countries. An important component of this arrangement would be that the partners would agree to refrain from bringing anti-dumping suits against each other for the period covered by Lomé V.

Fourthly, ACP countries would be enabled to participate in European institutional arrangements. This might take the form of various types of association with the Euro-Zone, of accreditation of professionals in ACP countries on the basis of European Union standards, and of the revision and updating of ACP commercial laws.

Finally, we propose a menu approach. The Lomé tradition is one which in principle offers the same package of aid and trade relations to all ACP countries. This insufficiently recognises the diversity of these countries. ACP countries differ both as to their needs and as to the preferences of their governments, both of which change. This can only be accommodated by a menu approach. That is, the European Union and the ACP countries would negotiate a range of options, each of which would consist of benefits and obligations. The Lomé treaty would then in fact describe the menu consisting of these options. The menu would include the options we have proposed: performance-based aid, reciprocal trade agreements and participation in supra-national institutions. In addition, it could include the *status quo* (that is, aid plus trade preferences), possibly an aid-only option, and options under which ACP countries would undertake to go beyond minimum requirements in, say, environmental policies or the protection of human rights. Once the European Union and the ACP governments have agreed the options, each country would be free to choose which, if any, option it would take. An important advantage of the menu approach is that it would avoid donors taking decisions on which combination of aid and trade is appropriate for a particular country.

Twenty years ago the governments of the ACP countries were much more homogeneous in terms of needs and preferences than they are today. The idea of a 'Lomé à la carte' takes this explicitly into account. Over the past twenty years, in some countries policy has deteriorated, whereas in others, governments have now created the domestic pre-conditions for rapid growth and need external assistance in innovative forms to transform these from necessary to sufficient conditions for take-off. The menu approach allows these governments to self-select. It is for governments to self-select into appropriate external assistance on the basis of their ambitions rather than for the European Union to pre-select on the basis of structural characteristics.

REFERENCES

Azam, J.-P. (1995), 'How to Pay for the Peace', *Public Choice*, 83.

Bartlett, R. (1994), *The Making of Europe* (Penguin).

Bates, R.H. and P. Collier (1995), 'The Political Economy of Rebellion' (Harvard, mimeo).

Bhattasali, D. and A. Ray (1995), 'Sub-Saharan Africa: Policies and Outcomes' (Africa Region, World Bank, mimeo).

Boone, P. (1996), 'Politics and the Effectiveness of Foreign Aid', *European Economic Review*, **40**, 289-330.

Burnside, C. and D. Dollar (1996), 'Aid, Policies and Growth' (Policy Research Department, World Bank, mimeo).

Collier, P. (1995), 'The Marginalisation of Africa in the World Economy', *International Labour Review*.

Collier, P. (1996), 'On the Economic Consequences of Civil War' (CSAE, Oxford, mimeo).

Collier, P. and J.W. Gunning (1995), 'Trade Policy and Regional Integration: Implications for the Relations between Europe and Africa', *The World Economy*, **18**, 387-410.

Collier, P. and A. Hoeffler (1996), 'On the Economic Causes of Civil War' (CSAE, Oxford, mimeo).

Collier, P. and J.W. Gunning with associates (forthcoming), *Trade Shocks in Developing Countries* (Clarendon Press, Oxford).

Collier, P., P. Guillaumont, S. Guillaumont and J.W. Gunning (1997), 'Redesigning Conditionality', *World Development*, **25**.

Easterly, W. and R. Levine (1995), 'Africa's Growth Tragedy' (World Bank, mimeo).

Grilli, E. (1993), *The European Community and the Developing Countries* (Cambridge University Press).

Haque, N.U., M. Nelson and D.T. Mathieson (1997), 'Creditworthiness Ratings: Their Political and Economic Content', in P. Collier and C. Pattillo (eds.), *Risk and Agencies of Restraint: Reducing the Risks of African Investment* (London: Macmillan).

Herbst, J. (1990), 'War and the State in Africa', *International Security*, **14**, 4, 117–39.

Hermann, R., K. Burger and H.P. Smit (1990), 'Commodity Policy: Price Stabilization versus Financing', in D.A. Sapsford and L.A. Winters (eds.), *Primary Commodity Prices: Economic Models and Policy* (Cambridge: Cambridge University Press).

International Finance Corporation (1995), *Trends in Private Investment in Development Countries* (IFC, Washington DC).

Mauro, P. (1995), 'Corruption and Growth', *Quarterly Journal of Economics*, **110**, 686–712.

Oyejide, A., B. Ndulu and J.W. Gunning (1997), 'Regional Integration and Trade Liberalisation: Evidence from Country Case Studies. Introduction and Overview' in Oyejide, Ndulu and Gunning (eds.) *Regional Integration and Trade Liberalisation in Sub-Saharan Africa, Vol 2, Country Case Studies* (Basingstoke and London, Macmillan).

Singer, J.D. and M. Small (1994), 'Correlates of War Project: International and Civil War Data 1816–1992' (An Arbor, Michigan, Inter-University Consortium for Political and Social Research).

Tirole, J. (1992), 'On Corruption', Institute for Policy Reform Working Paper 53 (Washington, DC).

World Bank (1994), *Adjustment in Africa: Reforms, Results and the Road Ahead* (Oxford University Press).